

PRC REGULATION AND SUPERVISION

The banking industry is heavily regulated in China, with the CBRC and the PBOC acting as the principle regulatory authorities. The CBRC is responsible for supervising and regulating banking institutions, and the PBOC, as the central bank of China, is responsible for formulating and implementing monetary policies. The applicable laws and regulations governing activities in China's banking industry consist principally of the PRC PBOC Law, the PRC Commercial Banking Law and the PRC Banking Regulation and Supervision Law, and the rules and regulations promulgated thereunder.

Principal Regulators

Prior to April 2003, the PBOC acted as both China's central bank and the principal supervisor and regulator of the banking industry in China. In April 2003, the CBRC was established to become the primary banking industry regulator and assumed majority of the bank regulatory functions from the PBOC. The PBOC retained its role as the central bank.

The CBRC

Functions and Powers

The CBRC is the primary supervisory authority responsible for the regulation of banking institutions operating in China, including commercial banks, urban credit cooperatives, rural credit cooperatives, other deposit-taking financial institutions and policy banks, and certain non-banking financial institutions under its authority such as asset management companies, trust and investment companies, finance companies, financial leasing companies, as well as branches and representative offices established by foreign financial institutions in China. According to the PRC Banking Supervision and Regulation Law enacted in December 2003, the main responsibilities of the CBRC include:

- setting and promulgating rules and regulations governing banking institutions and their business activities;
- regulating the establishment, change, dissolution and business scope of banking institutions, as well as granting banking licenses for commercial banks and their branches;
- regulating the business activities of banking institutions, including the products and services they offer;
- setting qualification requirements for, and approving or overseeing the nomination of, directors and senior management personnel of banking institutions;
- setting guidelines and standards for internal controls, risk exposure and corporate governance of, and disclosure requirements for, banking institutions;
- conducting on-site inspection and off-site surveillance of the business activities of banking institutions;
- monitoring the financial condition of banking institutions, including establishing standards or requirements for capital adequacy, asset quality and other financial metrics; and
- imposing corrective and punitive measures for violations of applicable banking regulations.

Examination and Supervision

The CBRC, through its head office in Beijing and offices in each province, provincial-level municipality and autonomous region, monitors the operations of commercial banks and their branches through on-site inspections and off-site surveillance. On-site inspections generally include visiting the banks' premises, interviewing bank employees and, for significant issues relating to banks' operations or risk management, senior management and directors, as well as reviewing documents and materials maintained by the banks. The CBRC also conducts off-site surveillance by reviewing financial and other reports regularly submitted by the

banks. If a banking institution is not in compliance with a regulation, the CBRC has the power to issue corrective and punitive measures, including imposition of fines, suspension of certain business activities, restrictions on distributions of dividends and other income and asset transfers, closure of the institution and other penalties.

The PBOC

As the central bank of the PRC, the PBOC is responsible for formulating and implementing monetary policies and maintaining the stability of the financial markets. According to the PRC PBOC Law, the PBOC is empowered to:

- formulate and implement monetary policies by establishing benchmark interest rates, setting the deposit reserve ratios for commercial banks, extending loans to commercial banks, accepting discounted bills and conducting open market operations;
- issue PRC treasury bills and other government bonds to financial institutions, as the agent of the MOF;
- regulate the inter-bank lending market and inter-bank bond market;
- set foreign exchange rate policies and manage China's foreign exchange reserves and gold reserves;
- manage the state treasury;
- maintain the normal operation of payment and settlement systems;
- regulate and examine foreign exchange activities; and
- establish anti-money laundering guidelines and monitor fund transfers to ensure that such transfers are in compliance with anti-money laundering regulations.

Other Regulatory Authorities

In addition to the CBRC and the PBOC, commercial banks in the PRC are also subject to the supervision and regulation by other regulatory authorities including, among others, the SAFE, the CSRC and the CIRC. For example, in conducting our foreign exchange business, we are subject to the regulation of the SAFE; in conducting our funds custodian business, we are subject to the regulation of the CSRC; and in conducting our bancassurance business, we are subject to the regulation of the CIRC.

Licensing Requirements

Basic Requirements

The Commercial Banking Law and the CBRC Measures for the Implementation of Administrative Licensing Regarding Domestic-funded Commercial Banks as effective on February 1, 2006, define the business scope of commercial banks and establishes licensing standards and other requirements. The establishment of a commercial bank requires the CBRC's approval and issuance of an operating license. In general, the CBRC will not approve an application for establishing a commercial bank unless certain conditions are satisfied, among others:

- the articles of association of the proposed commercial bank comply with relevant requirements of the Commercial Banking Law and the PRC Company Law;
- the registered capital of the proposed bank meets the minimum requirement under the Commercial Banking Law. The minimum registered capital for a national commercial bank, city commercial bank and rural commercial bank is RMB 1 billion, RMB 100 million and RMB 50 million, respectively;
- the directors and senior management of the proposed bank must possess the requisite qualifications;

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- the organizational structure and management system must be properly established; and
- the business premises, safety and preventive measures and other operational facilities must comply with relevant requirements.

Significant Changes

Banks are required to obtain the CBRC's approval if they undergo any significant change, including, among others:

- change of name;
- change in the bank's registered capital;
- change of the location of the head office or a branch;
- change in the bank's business scope;
- any purchase of an equity interest in the bank that results in the purchaser becoming a holder of 5% or more of the bank's shares or any change in equity interests of shareholders holding 5% or more of the bank's total capital or shares;
- amendment to the articles of association;
- merger or separation; and
- dissolution and liquidation.

Establishment of Branches

Domestic Branches

A commercial bank must apply to the CBRC or its local offices for approval and issuance of an operating license to establish a branch. A branch must have sufficient operating funds commensurate with its scale and must meet other operating requirements. The sum of the operating funds provided to all branches of a bank may not exceed 60% of the total capital of the bank.

Overseas Branches

The establishment of overseas branches by PRC commercial banks is subject to the CBRC's approval in addition to complying with all applicable regulations in the relevant foreign jurisdiction. The applicant bank is required to meet the following conditions:

- (1) its capital adequacy ratio shall not be lower than 8%;
- (2) the balance of its equity investments shall generally not exceed 50% of its net assets;
- (3) it shall have maintained a favorable balance in the most recent three accounting years;
- (4) the balance of its year-end assets in the preceding year prior to the application shall be RMB 100 billion or more;
- (5) it shall have lawful and sufficient sources of foreign exchange funds;
- (6) it shall have a good corporate governance structure and a sound and effective internal control system;
- (7) its main prudent supervisory indices shall meet the supervisory requirements; and
- (8) other prudent conditions as prescribed by the CBRC.

Scope of Business

Under the PRC Commercial Banking Law, commercial banks in China are permitted to engage in any or all of the following activities:

- taking deposits from the public;
- making short-term, medium-term and long-term loans;
- effecting domestic and overseas payment settlements;
- accepting and discounting instruments;
- issuing bonds;
- acting as agents to issue, honor and underwrite government bonds;
- trading government bonds and bonds from financial institutions;
- engaging in inter-bank lending;
- trading foreign exchange as principal or as agent;
- engaging in bank card business;
- providing letters of credit and guarantee services;
- collecting and making payment as agents and acting as insurance agents as an ancillary business;
- providing safe deposit box service; and
- other businesses approved by the CBRC.

Commercial banks in China are required to stipulate their scope of business in their articles of association and submit their articles of association to the CBRC for its approval.

Regulation of Principal Commercial Banking Activities

Lending

PRC banking regulations require that commercial banks take into consideration government macroeconomic policies when making lending decisions. Accordingly, commercial banks are encouraged to restrict their lending to borrowers in restricted industries in compliance with relevant government policies. For example, in an effort to slow the growth of real estate market in China, the State Council approved the Opinion of Adjusting the Structure of Housing Supply and Stabilizing Housing Prices. Among other measures, effective on June 1, 2006, the opinion increased the minimum requirement for a down payment from 20% to 30% of the purchase price of a mortgaged residential property (other than for apartments with a gross floor area of 90 square meters or less used as the borrower's own residence, for which the minimum down payment remains 20%). This increase in the minimum down payment requirement is expected to reduce the level of residential mortgage lending. In addition, commercial banks may not extend credit in connection with or for the purpose of the business involving products and activities that are expressly prohibited by the PRC Government, or in violation of relevant laws and regulations by using the extended credit for the investment in equity interests, stocks, futures and derivative products.

In order to control credit risks associated with credit operations, commercial banks are required to, among others: (i) establish a strict and centralized system for credit risk management; (ii) set out standard operating procedures at each stage of credit operations, including conducting due diligence investigations before extending credit, monitoring the borrowers ability to repay the loan and preparing written credit assessment on a regular basis; and (iii) arrange competent personnel.

The CBRC has issued several guidelines and measures to control market risk associated with related party loans. See “— Corporate Governance and Risk Control — Transaction with Related Parties.”

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As part of the effort to control the credit risk of China's commercial banks, the CBRC issued regulations governing loans and credit granted to certain specific industries and customers. For example,

- Under the Guidelines on Business Risk Management of Credit Extension to Group Companies by Commercial Banks, effective on October 23, 2003, commercial banks are required to treat affiliated companies of the same group as a single group customer and establish a single consolidated credit limit for such group. Moreover, commercial banks shall take measures to diversify risks if the total credit granted to a group customer accounts for more than 15% of the bank's regulatory capital.
- Under the Guidelines on Risk Management of Commercial Banks' Real Estate Loans, banks are prohibited from making loans to real estate developers unless they have funded a minimum of 35% of the total investment of the real estate development project in the form of equity.
- Under the Automobile Loan Measures, effective on October 1, 2004, commercial banks are prohibited from making loans for automobiles that are for personal use, commercial automobiles and second-hand automobiles exceeding 80%, 70% and 50%, respectively, of the purchase price of such automobiles.

Foreign Exchange Business

Commercial banks are required to obtain approvals from CBRC and SAFE in order to conduct foreign exchange business. As of December 31, 2006, our head office and each of our branch outlets providing settlement for and sale of foreign exchange services have obtained the required approvals, filings or certificates to conduct such business from the relevant foreign exchange regulatory authorities. Under PRC's anti-money-laundering laws and regulations, PRC financial institutions are required to report to the Anti-Money Laundering Monitoring and Analyzing Center on a timely basis the transactions involving large amounts of Renminbi and foreign exchange transactions and suspicious transactions.

Under the Notice on Further Improving the Administration of Foreign Exchange Income and Settlement in Trade that was issued on September 29, 2006 and became effective on November 1, 2006, banks must conduct a stringent review of the foreign exchange settlement by those enterprises identified as "special mention enterprise" by the SAFE, and strengthen the examination of foreign currency inflow related to trade business in strict compliance with the aforementioned and other relevant regulations on foreign exchange controls.

Personal Wealth Management

Under the Provisional Measures on Personal Wealth Management Business of Commercial Banks that became effective on November 1, 2005, commercial banks must apply for approval from or report to the CBRC before they can provide certain personal wealth management services. Commercial banks are also subject to certain restrictions in the offering of products under personal wealth management plans. In addition, under the Guidelines on Risk Management Regarding Personal Wealth Management Business that took effect on November 1, 2005, commercial banks are required to both establish relevant systems for analyzing, auditing and reporting of personal wealth management business and to report major risk management issues to relevant authorities. Furthermore, the Provisional Measures for Overseas Wealth Management by Commercial Banks that took effect on April 17, 2006 allow commercial banks to conduct overseas wealth management business subject to the approval from the CBRC.

Securities and Asset Management Businesses

Commercial banks in China are generally prohibited from trading and underwriting equity securities. Commercial banks in China are permitted to:

- underwrite and deal in PRC Government bonds and bonds issued by financial institutions, starting from May 2005, underwrite and deal in short-term commercial papers issued by qualified non-financial institutions in the inter-bank bond market, and starting from December 2005, deal in qualified corporate bonds in the inter-bank bond market;

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- act as agents in transactions involving securities, including bonds issued by the government, corporate entities and financial institutions;
- provide asset management advisory services to institutional and individual investors;
- act as financial advisors in connection with large infrastructure projects, mergers and acquisitions, and bankruptcy reorganizations; and
- act as custodian for investments funds, including securities investment funds and corporate annuity funds.

Under the Trial Administrative Measures on Fund Management Companies Owned by Commercial Banks, the Big Four commercial banks and the Other National Commercial Banks are permitted to establish or acquire fund management companies, upon approval by the CBRC and the CSRC. Commercial banks are required to implement detailed measures to segregate risks associated with the securities market and the banking sector, which include, among others, separating client information between commercial banks and their fund management companies, preventing commercial banks' employees from holding concurrent positions in the fund management companies established by such commercial banks and prohibiting commercial banks from acting as custodians for the funds managed by their fund management companies.

Under the Administrative Measures on Qualifications for Securities Investment Fund Custodianship effective in January 2005, a commercial bank is permitted to apply for the qualification to engage in fund custodian business of securities investment funds, if, among other requirements, such commercial bank has net assets at the year-end totaling not less than RMB 2 billion for each of the last three fiscal years and its capital adequacy ratio meets the relevant regulatory requirement. The fund custodian must ensure the separation of its custodian business from its other businesses and the independence of its fund assets. The CSRC and the CBRC are jointly responsible for examining and approving the qualifications and supervising the activities of fund custodians. In addition, the senior manager to be appointed for a commercial bank's fund custody department must meet certain qualifications and be approved by the CSRC.

Securitization of Credit Assets of Financial Institutions

The Measures for the Pilot Supervision and Administration of the Securitization of Credit Assets of Financial Institutions was promulgated by the CBRC on November 7, 2005 and became effective on December 1, 2005. These measures shall apply to those structural financing activities carried out in the PRC where a banking financial institution, as the promoter institution, entrusts the credit assets to a trustee institution, and the trustee institution issues beneficial securities to investment institutions in the form of asset-backed securities and pays the yields from asset-backed securities by the cash generated from the aforesaid assets. The term "promoter institutions for the securitization of credit assets" refers to the financial institutions that transfer the credit assets by establishing special purpose trusts. A banking financial institution, as the promoter institution, is required to meet specific conditions and obtain the approval by the CBRC.

Insurance

Commercial banks in China are not permitted to underwrite insurance policies, but are permitted to act as agents to sell insurance products through their distribution networks. Commercial banks providing insurance agency services are required to comply with any applicable rules issued by the China Insurance Regulatory Commission, the regulator for China's insurance industry. Pursuant to the Interim Measures on the Administration of Ancillary Agency Insurance Business promulgated by the CIRC on August 4, 2000, commercial banks are required to obtain licenses from the CIRC before conducting agency insurance business. In accordance with the Notice Regarding Standardization of Agency Insurance Business Conducted by Banks issued by the CIRC and the CBRC on June 15, 2006, such licenses are required for all tier one branches of commercial banks conducting such business. As of December 31, 2006, all of our tier one branches providing insurance agency services have obtained the required licenses to provide such services from the relevant insurance regulatory authorities.

Proprietary Investments

In general, commercial banks in China are prohibited from making domestic investments other than in debt instruments issued by the government and financial institutions, commercial paper and corporate bonds issued by qualified non-financial institutions, and certain derivative products. Unless approved by the PRC Government, commercial banks are prohibited in China from engaging in trust investment business, securities operations, investing in real estate other than for their own use, and making equity investments in non-banking financial institutions and entities.

Derivatives

Under the Tentative Administrative Measures on Trading of Derivatives by Financial Institutions, commercial banks in China seeking to conduct a derivatives business must obtain prior approval from the CBRC by meeting relevant qualification requirements, which include, among others, the establishment of a sound risk management system that monitors risk on a real-time basis; a sound internal control system; and an effective processing system for derivatives transactions. In addition, the bank must have a competent professional team to conduct the derivatives business. Banks conducting derivatives business are required to strictly implement trading and exposure authorization limits and stop loss limits. They are also required to comply with detailed requirements relating to corporate governance and internal controls, including approval procedures for new products, as well as risk supervision and assessment.

Electronic Banking

In January 2006, the CBRC issued the Administrative Measures on Electronic Banking Business and the Guidelines on Electronic Banking Security Evaluation in an effort to enhance risk management and security standards in this fast-growing sector. All banking institutions applying to establish an e-banking business are required to have sound internal control and risk management system and should not have any major incidents relating to their primary information management and operations processing systems in the year prior to application. In addition, all banking institutions conducting e-banking business must adopt security measures to protect highly confidential data and the security of transaction information and prevent the unauthorized use of e-banking accounts.

Pricing of Products and Services

Interest Rates for Loans and Deposits

Interest rates for RMB-denominated loans and deposits were historically set by the PBOC. In recent years, the PBOC has been gradually liberalizing its regulation of interest rates, allowing banks to set interest rates within permitted bands around the benchmark rates set by the PBOC.

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The following table sets forth the applicable benchmark interest rates in effect for the periods indicated.

PBOC benchmark interest rates for RMB-denominated loans and deposits						
	From 06/10/99 to 02/20/02	From 02/21/02 to 10/28/04	From 10/29/04 to 04/27/06	From 04/28/06 to 08/18/06	From 08/19/06 to 03/17/07	Since 03/18/07
	(% per annum)					
Loans						
<u>Short-term loans:</u>						
Less than six months	5.58%	5.04%	5.22%	5.40%	5.58%	5.67%
Six months to one year	5.85	5.31	5.58	5.85	6.12	6.39
<u>Medium- and long-term loans:</u>						
One to three years	5.94%	5.49%	5.76%	6.03%	6.30%	6.57%
Three to five years	6.03	5.58	5.85	6.12	6.48	6.75
More than five years	6.21	5.76	6.12	6.39	6.84	7.11
<u>Residential mortgage loans:</u>						
Five years or less	5.31%	4.77%	4.95% ⁽¹⁾	6.12%	6.48%	6.75%
More than five years	5.58	5.04	5.31 ⁽¹⁾	6.39	6.84	7.11
Deposits						
Demand deposits	0.99%	0.72%	0.72%	0.72%	0.72%	0.72%
<u>Time deposits:</u>						
Three months	1.98%	1.71%	1.71%	1.71%	1.80%	1.98%
Six months	2.16	1.89	2.07	2.07	2.25	2.43
One year	2.25	1.98	2.25	2.25	2.52	2.79
Two years	2.43	2.25	2.70	2.70	3.06	3.33
Three years	2.70	2.52	3.24	3.24	3.69	3.96
Five years	2.88	2.79	3.60	3.60	4.14	4.41

(1) Effective March 17, 2005, the PBOC benchmark mortgage rates are the same as the PBOC benchmark rates for loans with the same terms.

As the PRC Government further liberalizes the interest rate regime, banks have been given more discretion in determining the interest rates that may be charged on RMB-denominated loans and the interest rates that may be offered on RMB-denominated deposits. The following table sets forth the permitted interest rate bands for RMB-denominated loans and deposits at the dates indicated.

	Loans			Deposits		
	Between 09/01/99 and 12/31/03 ⁽¹⁾	Between 01/01/04 and 10/28/04 ⁽²⁾	Since 10/29/04 ⁽³⁾	Between 09/01/99 and 12/31/03	Between 01/01/04 and 10/28/04	Since 10/29/04
Maximum interest rates	Up to 130% of the PBOC benchmark rate for SMEs (up to 150% for rural credit cooperatives) and up to 110% for large enterprises	Up to 170% of the PBOC benchmark rate (up to 200% for rural credit cooperatives)	No cap (up to 230% of the PBOC benchmark rate for rural and urban credit cooperatives)	PBOC benchmark rate except for negotiated deposits	PBOC benchmark rate except for negotiated deposits	PBOC benchmark rate except for negotiated deposits
Minimum interest rates	Not lower than 90% of the PBOC benchmark rate	Not lower than 90% of the PBOC benchmark rate	Not lower than 90% of the PBOC benchmark rate	PBOC benchmark rate except for negotiated deposits	PBOC benchmark rate except for negotiated deposits	No minimum

(1) Interest rates for residential mortgage loans, public assistance loans, policy loans and certain other loans specified by the State Council may not exceed the PBOC benchmark rate.

(2) Interest rates for residential mortgage loans, public assistance loans and certain other loans specified by the State Council may not exceed the PBOC benchmark rate. Interest rates for automobile loans may not be lower than 10% of the PBOC benchmark rate or higher than 70% of the PBOC benchmark rate.

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- (3) From March 17, 2005 to August 18, 2006, interest rates for residential mortgage loans were adjusted to the same level of interest rate as most other types of loans. Since August 19, 2006, the minimum interest rates for the residential mortgage loans have been changed to 85% of the relevant PBOC benchmark rate.

Prior to January 1, 2004, all RMB-denominated loans (except mortgage loans and certain specific types of loans) with a maturity of one year or less were required to have fixed interest rates within a specific range based on the applicable PBOC benchmark rates, and all RMB-denominated loans (except mortgage loans and certain specific types of loans) with a maturity longer than one year were required to have interest rates adjusted following each change of the applicable PBOC benchmark rates. When the applicable PBOC benchmark rates changed, the interest rates for all such adjustable loans were generally adjusted on the next anniversary of the loan origination date following the date of change.

On January 1, 2004, the PBOC expanded the range within which banks were allowed to set their interest rates based on the PBOC benchmark rates for the above mentioned loans. In addition, RMB-denominated loans with a maturity longer than one year were allowed to bear either fixed interest rates or adjustable interest rates that adjust on a monthly, quarterly or annual basis following each adjustment of the PBOC benchmark rates. On October 29, 2004, the PBOC further liberalized interest rate regulation by removing the upper limit for RMB-denominated loans (except mortgage loans and certain specific types of loans), allowing banks to determine their interest rates for such loans so long as they are not lower than 90% of the relevant PBOC benchmark rates.

As for mortgage loans, prior to March 17, 2005, the PBOC fixed the interest rates on residential mortgage loans and entrusted provident housing fund mortgage loans at a level lower than the benchmark rates of other loans with corresponding terms. Following each change by the PBOC of the interest rates for mortgage loans, banks were required to make the corresponding adjustment of their interest rates for such outstanding mortgage loans on January 1 of the year following the date of change. Since March 17, 2005, interest rates for residential mortgage loans have then same readjustment mechanism as other commercial loans. Since August 19, 2006, the minimum interest rates for residential mortgage loans have been changed to 85% of the relevant PBOC benchmark rate. Regulation on entrusted provident housing fund loans, however, remains the same.

As for automobile and other loans to individuals, prior to October 28, 2004, interest rates for such loans were permitted to range from 10% lower than PBOC benchmark rate to 70% higher than the PBOC benchmark rate. Since October 29, 2004, interest rate for such loans are subject to a minimum equal to 90% of the PBOC benchmark rate and no maximum interest rate is imposed on such loans.

Starting from October 29, 2004, commercial banks in China are permitted to set their own interest rates on Renminbi deposits so long as such interest rates are not higher than the relevant PBOC benchmark rates. However, these restrictions do not apply to interest rates on negotiated deposits, which are deposits by PRC insurance companies in amounts of RMB 30 million or more or deposits by the SSF in amounts of RMB 500 million or more, both with a term longer than five years, or deposits by China Post in amounts of RMB 30 million or more with a term longer than three years.

The PBOC generally does not regulate interest rates for foreign currency-denominated loans and generally does not regulate foreign currency-denominated deposits other than U.S. dollar-, Hong Kong dollar-, Japanese yen- or Euro-denominated deposits of less than US\$3 million (or the equivalent) with a maturity of one year or less, the interest rates on which may not exceed the PBOC maximum interest rates for small amount foreign currency-denominated deposits.

Commercial banks are generally allowed to set interest rates for discounted bills based on the PBOC rediscount rates. The PBOC rediscount rate was 2.16% from June 10, 1999 to September 10, 2001, 2.97% from September 11, 2001 to March 24, 2004, and has been 3.24% since March 25, 2004.

Pricing for Non-interest Income Products and Services

Under the Tentative Administrative Measures on Pricing of Commercial Banking Services effective in October 2003, the services which are subject to government pricing guidelines include basic Renminbi

settlement services, such as bank drafts, bank acceptance drafts, promissory notes, checks, remittances, entrusted collection, and other services specified by the CBRC and the NDRC. Fees for other products and services are determined by banks based on market conditions. Banks are also required to report to the CBRC at least fifteen business days prior to the implementation of new fee schedules and to publish such fee schedules in their relevant business premises at least ten business days prior to their implementation.

Operating Requirements

Statutory Deposit Reserve and Surplus Deposit Reserve

Commercial banks are required to maintain a percentage of their total deposits with the PBOC to ensure they have sufficient liquidity for customer withdrawals.

After April 16, 2007, most commercial banks are required to maintain a reserve ratio of 10.5% of total outstanding Renminbi deposits calculated under the PBOC regulations. Those banks which fail to meet certain PBOC standards are required to maintain a reserve ratio of 11.0%. The minimum statutory deposit reserve ratio was increased from 7.0% to 7.5% in April 2004, to 8.0% in July 2006, to 8.5% in August 2006, to 9.0% in November 2006, to 9.5% in January 2007, to 10.0% in February 2007, and to 10.5% in April 2007. In addition, domestic and foreign invested commercial banks must maintain surplus deposit reserves with the PBOC, which are deposits exceeding the statutory deposit reserve. Surplus deposit reserves are used in part for settlement purposes. Since a reform of the deposit reserve system in 1998, the PBOC has actively monitored the levels of surplus deposit reserves maintained by commercial banks in an effort to ensure that the banks have sufficient funds to meet their settlement obligations.

Prior to January 15, 2005, domestic commercial banks licensed to conduct foreign exchange activities were required to maintain a reserve ratio equal to 2% of their monthly average foreign currency deposits during the preceding quarter. Foreign-invested banks were required to maintain a reserve ratio equal to 5% of total deposits with terms of less than three months and 3% for deposits with terms of three months or more. From January 15, 2005 to September 14, 2006, both domestic banks and foreign-invested banks are required to maintain 3% of their total foreign currency-denominated deposits at the end of the previous month, which was increased to 4% beginning September 15, 2006.

The PBOC pays interest on deposit reserves maintained by the commercial banks. Since February 21, 2002, the interest rate for Renminbi statutory deposit reserves has been 1.89%. The PBOC has lowered the interest rates it pays on banks' surplus deposit reserves twice since February 21, 2002: from 1.89% to 1.62% on December 21, 2003, and from 1.62% to 0.99% on March 17, 2005. The PBOC does not pay interest on foreign currency deposit reserves maintained by the commercial banks.

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Operational and Risk Management Ratios

Before the Core Indicators (Provisional) took effect in January 2006, commercial banks were required to calculate liquidity and other operational ratios in accordance with the PRC Commercial Banking Law and the Examination Measures and Supervision Indicators Relating to the Administration of Assets and Liabilities Ratios of Commercial Banks (the “Examination Measures”) issued by the PBOC in 1996. The following table sets forth, as of the dates indicated, the required liquidity and other operational ratios for commercial banks in the PRC, as well as our ratios as reported to the PBOC and the CBRC, which were calculated in accordance with the formula promulgated by the PBOC in 1996 and based on our balance sheet data prepared in accordance with the then applicable PRC GAAP.

	Requirement	As of December 31,	
		2004	2005
(in percentages)			
Liquidity ratios			
Renminbi current assets to Renminbi current liabilities	≥25.0%	61.28%	60.69%
Foreign currency current assets to foreign currency current liabilities	≥60.0	74.52	68.00
Loan-to-deposit ratios			
Renminbi loans to Renminbi deposits	≤75.0	71.86	66.43
Foreign currency loans to foreign currency deposits	≤85.0	35.90	37.77
Borrower concentration ratios			
Total outstanding loans to one single borrower to regulatory capital ⁽¹⁾	≤10.0	13.59	8.49
Total loans to top ten borrowers to regulatory capital ⁽¹⁾	≤50.0	66.94	46.41
Inter-bank ratios			
Total RMB inter-bank borrowings from other banks and financial institutions to total RMB deposits	≤4.0	0.00	0.00
Total RMB inter-bank lending to other banks and financial institutions to total RMB deposits	≤8.0	0.14	0.08
Reserve ratios			
RMB reserve deposits with the PBOC plus RMB cash to RMB deposits	≥5.0	12.90	11.28
Foreign currency deposits with other financial institutions plus cash in foreign currencies to total foreign currency deposits	≥5.0	3.27	4.50

(1) Our regulatory capital as of December 31, 2004 and 2005 was calculated in accordance with CBRC guidelines. See “Regulation and Supervision — PRC Regulation and Supervision — Regulations Regarding Capital Adequacy — Capital Adequacy Guidelines” and “Financial Information — Capital Resources — Capital Adequacy.”

As of December 31, 2005, we were not in compliance with the required ratio of foreign currency deposits with other financial institutions plus cash in foreign currencies to total foreign currency deposits. The Examination Measures was superseded by the Core Indicators (Provisional) on January 1, 2006 and this ratio is no longer required by the CBRC under the Core Indicators (Provisional). However, we have not been subject to any regulatory actions or penalties due to the non-compliance with this ratio.

The Core Indicators (Provisional), which became effective on January 1, 2006, amended certain liquidity and operating ratios required under the Examination Measures and introduced certain new ratios. The Core Indicators (Provisional) are currently implemented on a trial basis in 2006, and the CBRC has encouraged commercial banks to submit suggestions for amending the Core Indicators (Provisional) to the CBRC. Accordingly, to date, the Core Indicators (Provisional) have not been strictly enforced.

As of December 31, 2006, we were not in compliance with the core liabilities ratio under the Core Indicators (Provisional). We have been advised by our PRC legal counsel, King & Wood, that neither the Core Indicators (Provisional) nor other applicable laws and regulations impose any administrative penalties for the non-compliance with this ratio, and the likelihood of any regulatory actions or penalties imposed against us due to the non-compliance with this ratio is remote. We intend to comply with the core liabilities

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ratio under the Core Indicators (Provisional) as soon as commercially reasonable. However, we take into account various commercial factors, such as cost of capital, in adjusting our liabilities structure.

The following table sets forth the required ratios as provided in the Core Indicators (Provisional) and our ratios as of December 31, 2006. Although the CBRC has not requested commercial banks to submit these ratios, it has required commercial banks to submit certain data that are used to calculate some of these ratios.

<u>Risk Level</u>	<u>Primary Indicators</u>	<u>Secondary Indicators</u>	<u>Requirement</u>	<u>As of December 31, 2006</u>	
Risk Level					
Liquidity risk	Liquidity ratio ⁽¹⁾		≥25%	Renminbi	38.66%
				Foreign currency	99.98%
	Core liabilities ratio ⁽²⁾		≥60%		56.17%
	Liquidity gap ratio ⁽³⁾		≥(10%)		10.00%
Credit risk	Non-performing asset ratio ⁽⁴⁾		≤4%		2.45%
		Non-performing loan ⁽⁵⁾ ratio	≤5%		2.50%
		Credit concentration to a single group customer ⁽⁶⁾	≤15%		6.9%
		Loan concentration to a single customer ⁽⁷⁾	≤10%		6.7%
	Overall credit exposure to connected parties ⁽⁸⁾		≤50%		10.12%
Market risk	Cumulative foreign currency exposure ratio ⁽⁹⁾		≤20%		6.19%
Risk Cushion					
Profitability	Cost to income ratio ⁽¹⁰⁾		≤45%		43.85%
	Return on assets ⁽¹¹⁾		≥0.6%		0.61%
	Return on capital ⁽¹²⁾		≥11%		13.07%
Allowance adequacy	Allowance adequacy ratio for asset impairment ⁽¹³⁾		≥100%		160.84%
		Allowance adequacy ratio for loan impairment ⁽¹⁴⁾	≥100%		148.21%
Capital adequacy . . .	Capital adequacy ratio ⁽¹⁵⁾		≥8%		9.41%
		Core capital adequacy ratio ⁽¹⁶⁾	≥4%		6.57%

- (1) Calculated as follows: Liquidity ratio = Current assets/Current liabilities. Current assets include cash, gold, surplus deposit reserve, net inter-bank money market placement with maturities within one month, interest receivable and other receivables due within one month, qualified loans with maturities within one month, investment in debt securities with maturities within one month, debt securities that can be liquidated in the international secondary market any time and other liquidatable assets with maturities within one month (excluding the non-performing portion of such assets). Current liabilities include demand deposits (excluding policy deposits), time deposits with remaining maturities within one month (excluding policy deposits), net inter-bank money market taking due within one month, issued debt securities with maturities within one month, interest payable and other payables due within one month, borrowings from the PBOC due within one month and other liabilities due within one month.
- (2) Calculated as follows: Core liabilities ratio = Amount of core liabilities/Amount of total liabilities. Core liabilities refer to the combined amount of time deposit with remaining maturities of three months or longer, issued debt securities and idle demand deposits. Total liabilities refer to total liabilities on the Assets and Liabilities table prepared under the Accounting Principles of Financial Enterprises. As of December 31, 2006, our core liabilities ratio was 56.17%, which was lower than the required core liabilities ratio of 60%.
- (3) Calculated as follows: Liquidity gap ratio = Liquidity gap/Amount of on- or off-balance sheet assets with maturities within 90 days. Liquidity gap refers to the amount of on- or off-balance sheet assets with maturities within 90 days subtracted by the amount of on- or off-balance sheet liabilities within 90 days.
- (4) Calculated as follows: Non-performing asset ratio = Non-performing assets/Assets subject to credit risk. Non-performing assets include non-performing loans and other assets categorized as non-performing. Such non-loan assets subject to credit risk are categorized in accordance with relevant CBRC regulations.
- (5) Calculated as follows: Non-performing loan ratio = Non-performing loans/Total loans. Non-performing loans refer to loans in the substandard, doubtful and loss categories according to the PBOC and CBRC's five-category loan classification system.

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- (6) Calculated as follows: Credit concentration to a single group customer = Total credit granted to the largest group customer/Regulatory capital. Largest group customer refers to the group customer granted with the highest credit limit at the end of the period.
- (7) Calculated as follows: Loan concentration to a single customer = Total loans to the largest customer/Regulatory capital. Largest customer refers to the customer with the highest total loans outstanding at the end of the period.
- (8) Calculated as follows: Overall exposure to related parties = Total granted credit limit to all related parties/Regulatory capital. Related parties include related individuals, legal persons or other entities. Related parties refer to parties defined in the Related Party Transactions Measures. Total granted credit limit to all related parties refers to total credit limit granted to such parties subtracted by cash deposit guarantees and collateral in the form of bank deposits and PRC Government bonds.
- (9) Calculated as follows: Cumulative foreign currency exposure ratio = Cumulative foreign currency exposure/Regulatory capital. Cumulative foreign currency exposure refers to exchange rate sensitive foreign currency assets subtracted by exchange rate sensitive foreign currency liabilities.
- (10) Calculated as follows: Cost to income ratio = Operating expenses/Operating income. The main text of the Core Indicators (Provisional) sets forth the required ratio as $\leq 45\%$, but the appendix of the Core Indicators (Provisional) sets forth the ratio as $\leq 35\%$.
- (11) Calculated as follows: Return on assets = Net profit/Average balance of total assets for the period.
- (12) Calculated as follows: Return on capital = Net profit/Average balance of shareholders' equity for the period.
- (13) Calculated as follows: Allowance adequacy ratio for asset impairment = Actual amount of allowance for assets subject to credit risk/Required amount of allowance for assets under credit risk.
- (14) Calculated as follows: Allowance adequacy ratio loan impairment = Actual amount of allowance for loans/Required amount of allowance for loans.
- (15) See “— Regulations Regarding Capital Adequacy.”
- (16) See “— Regulations Regarding Capital Adequacy.”

The Core Indicators (Provisional) defined certain other ratios without providing the specific ratio requirement, including ratios relating to interest rate risk sensitivity, operational risk and loan migration. The CBRC may provide the requirement for those ratios in the future.

Regulations Regarding Capital Adequacy

Capital Adequacy Guidelines

PRC commercial banks are subject to a minimum capital adequacy ratio of 8% and a minimum core capital adequacy ratio of 4%. Prior to March 1, 2004, a commercial bank's capital adequacy ratios were calculated as follows:

$$\text{Capital adequacy ratio} = \frac{\text{Regulatory capital}}{\text{On- and off-balance sheet risk weighted assets}} \times 100\%$$

$$\text{Core capital adequacy ratio} = \frac{\text{Core capital}}{\text{On- and off-balance sheet risk weighted assets}} \times 100\%$$

In the preceding formula, core capital included paid-in capital, capital reserves, surplus reserves and retained earnings. Regulatory capital included both core capital and supplementary capital, less certain deductions (including equity investments in other banks and enterprises, and investments in real estate not for the bank's own use).

Supplementary capital included the general allowance for loan losses, bad debt and investment risk, and long-term bonds with a minimum original maturity of five years. Different risk weightings were assigned to cash, obligations of the PRC central government and the PBOC, loans to enterprises and individuals, inter-bank loans and other assets, as well as for off-balance sheet items.

In March 2004, the CBRC implemented new, more stringent capital adequacy guidelines applicable to all commercial banks in China. The new guidelines, the Administrative Measures on Capital Adequacy Ratios of Commercial Banks, provide for a phase-in period whereby all domestic banks must meet minimum capital adequacy ratios by January 1, 2007. Banks not immediately in compliance with the new guidelines must formulate and implement a capital replenishment plan under the supervision of the CBRC.

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While the new guidelines left the existing requirements of an 8% capital adequacy ratio and a 4% core capital adequacy ratio unchanged, they amended the risk weighting for a variety of assets and required deductions from core capital for certain kinds of assets. In addition, the new guidelines required commercial banks to make adequate allowances for various impairment losses, including for loans, before calculating their capital adequacy ratios. The capital adequacy ratio and core capital adequacy ratio are calculated in accordance with the PRC GAAP as follows:

$$\text{Capital Adequacy Ratio} = \frac{\text{Capital} - \text{Deductions from capital}}{\text{Risk-weighted assets} + (12.5 \times \text{capital charge for market risk})} \times 100\%$$

$$\text{Core Capital Adequacy Ratio} = \frac{\text{Core capital} - \text{Deductions from core capital}}{\text{Risk-weighted assets} + (12.5 \times \text{capital charge for market risk})} \times 100\%$$

Components of Capital

Total capital consists of core capital and supplementary capital. Supplementary capital may not exceed core capital.

Core capital includes the following items:

- paid-in capital or ordinary shares;
- capital reserves;
- surplus reserves;
- retained earnings; and
- minority interests.

Supplementary capital includes the following:

- up to 70% of the revaluation reserve;
- the general allowances for impairment losses under the CBRC's requirements (see “— Loan Classification, Allowances and Write-offs — Loan Classification” and “— Loan Allowances”);
- preference shares;
- qualifying bonds convertible into common shares; and
- qualifying subordinated debt with a maturity exceeding five years, but not exceeding 50% of core capital.

Deductions from total capital consist of the following:

- goodwill;
- equity investments in non-consolidated financial institutions; and
- capital investments in real estate not used for the bank's own operations or equity investments in non-banking institutions or enterprises.

Deductions from core capital consist of the following:

- goodwill;
- 50% of equity investments in non-consolidated financial institutions; and
- 50% of capital investments in real estate not used for the bank's own operations or equity investments in non-banking institutions or enterprises.

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Risk-weighted Assets

The guidelines provide for the calculation of risk-weighted assets net of any allowance for impairment losses by multiplying on-balance sheet items by their corresponding risk weighting, after taking into account risk mitigating factors. Off-balance sheet items, including foreign exchange contracts, interest rate contracts and other derivative contracts, are first converted to balance sheet credit-equivalent amounts by multiplying the nominal principal amount by a credit conversion factor. In addition, loans secured by certain types of pledges or guarantees are allocated the risk weighting of the pledges or guarantors. Partially pledged or guaranteed loans receive such lower risk-weighting only on the portion of the loan that is pledged or guaranteed. The following table sets forth risk weightings for different assets.

<u>Risk Weighting</u>	<u>Assets</u>
0%	<ul style="list-style-type: none"> ● Cash in vault ● Gold ● Claims on PRC incorporated commercial banks with an original maturity of four months or less ● Claims on the PRC central government or deposits at the PBOC ● Claims on the PBOC ● Claims on PRC policy banks ● Bonds issued by PRC financial asset management companies for the purpose of acquiring non-performing loans from state-owned banks ● Claims on non-PRC central governments or central banks in countries or regions where the sovereign or region is rated AA– or above⁽¹⁾ ● Claims on multilateral development banks
20%	<ul style="list-style-type: none"> ● Claims on PRC incorporated commercial banks with an original maturity of more than four months ● Claims on non-PRC commercial banks and securities companies incorporated in other countries or regions where the sovereign or region is rated AA– or above⁽¹⁾
50%	<ul style="list-style-type: none"> ● Residential mortgages ● Claims on PRC public-sector entities invested by the central government ● Claims on non-PRC public-sector entities invested by governments of countries or regions where the sovereign or region is rated AA– or above⁽¹⁾
100%	<ul style="list-style-type: none"> ● All other assets

(1) These ratings refer to credit ratings of Standard & Poor's or equivalent rating agencies.

Market Risk Capital

Since the first quarter of 2005, domestic banks with trading books greater than the lower of 10% of on-and off-balance sheet assets in aggregate and RMB 8.5 billion are required to take into consideration market risk arising from trading activities when determining capital adequacy. Market risk capital refers to the capital reserve that a bank is required to maintain for the market risks related to its assets. Market risk refers to the risk of losses in on and off-balance sheet positions arising from movements in market prices and includes risks related to interest-rate sensitive financial instruments and securities under trading accounts, and the foreign exchange risk and commodity risk of commercial banks.

Issuance of Fixed-term Subordinated Debt and Subordinated Bonds

Since November 2003, PRC commercial banks have been permitted to issue fixed-term subordinated debt for which the repayment of principal and interest is subordinated to the bank's other liabilities but is senior to the bank's equity capital. A PRC commercial bank may include such fixed-term subordinated debt in the bank's supplementary capital. To qualify for inclusion in the bank's supplementary capital, the subordinated debt must have a minimum term of five years and the proceeds must not be used to offset a bank's operating losses. Subordinated debt can be issued only through private placements to certain legal

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person institutions. Moreover, Fixed-term subordinated debt cannot be issued to other commercial banks. The issuance of subordinated debt by a PRC commercial bank is subject to the approval of the CBRC.

Since June 2004, PRC commercial banks have been permitted to issue bonds that are subordinated to the bank's other liabilities but are senior to the bank's equity capital. A PRC commercial bank may, upon approval by the CBRC, include such subordinated bonds in the bank's supplementary capital. Subordinated bonds can be issued either in a public offering in the inter-bank bond market or in a private placement. A PRC commercial bank may not hold an aggregate amount of subordinated bonds issued by other banks in excess of 20% of its core capital. The issuance of subordinated bonds by a commercial bank is subject to the approval of the CBRC. The PBOC regulates the issuance and trading of subordinated bonds in the inter-bank bond market.

Since December 2005, eligible commercial banks may issue hybrid capital bonds in the inter-bank market and include them in their supplementary capital. The introduction of hybrid capital bonds provided a new channel for banks in China to replenish their supplementary capital and improve their capital adequacy ratio.

CBRC Supervision of Capital Adequacy

The CBRC reviews and evaluates banks' capital adequacy through both on-site examination and off-site surveillance. Commercial banks are required to report to the regulators their unconsolidated capital adequacy ratios on a quarterly basis and their consolidated capital adequacy ratios on a semi-annual basis. Commercial banks are classified into three categories based on their capital adequacy as follows.

<u>Category</u>	<u>Capital adequacy ratio</u>		<u>Core capital adequacy ratio</u>
Adequately capitalized banks	no less than 8%	and	no less than 4%
Undercapitalized banks	less than 8%	or	less than 4%
Significantly undercapitalized banks	less than 4%	or	less than 2%

The actions the CBRC takes to enforce the capital adequacy requirements may vary based on the classification of a commercial bank. The CBRC may issue a supervisory notice letter to undercapitalized banks which includes corrective actions and a plan for implementing such actions. These actions may include among others:

- requiring the bank to submit and implement an acceptable capital restoration plan within two months after receiving the supervisory notice letter;
- restricting asset growth or reducing risk assets;
- restricting the purchase of fixed assets;
- restricting dividends and other forms of distributions;
- suspending all businesses except low-risk activities; and
- suspending the establishment of new branches, restricting the launch of new services or suspending the bank's entire business operations (except for low-risk activities).

Significantly undercapitalized banks may be required to take additional actions including the removal of senior management, transfer of control, restructuring of operations, or closure in accordance with relevant laws and regulations.

Basel Accords

The Basel Capital Accord, or Basel I, was introduced by the Basel Committee on Banking Supervision, or the Basel Committee, in 1988. Basel I is a capital measurement system for banks that provides for the implementation of a credit risk measurement framework with a minimum capital standard of 8%. Since 1999, the Basel Committee has issued certain proposals for the New Basel Accord, known as Basel II, to replace

Basel I. Basel II retains the key elements of Basel I, including the general requirement for banks to hold total capital equivalent to at least 8% of their risk-weighted assets, but seeks to improve the capital framework in various key aspects, including (i) making recommendations relating to capital requirements and credit risk measurement to improve the capital framework's sensitivity to credit risks, (ii) introducing supervision and review standards for banks to conduct internal assessments of their overall risks and (iii) enhancing the degree of transparency in banks' public reporting. Basel II is expected to be made available in its entirety at the end of 2007.

The CBRC has advised that the Regulation Governing Capital Adequacy of Commercial Banks issued in March 2004 was based on Basel I while taking into consideration certain aspects of Basel II.

Loan Classification, Allowances and Write-offs

Loan Classification

Banks in China are currently required to classify loans under a five-category classification system based on the estimated likelihood of repayment of principal and interest. Prior to the adoption of the five-category classification currently in effect, loans were generally classified into four categories — pass, overdue, non-performing and loss — primarily based on the status of repayment and whether the borrower had become bankrupt. The five-category classification was initially promulgated by the PBOC in 1999 on a pilot basis and in 2002 all banks were officially required to adopt it under the Loan Classification Principles. The primary factors for evaluating the likelihood of repayment include the borrower's cash flow, financial condition, and credit history. The table below sets forth the five classification categories and their corresponding definitions.

<u>Classification</u>	<u>Definition⁽¹⁾</u>
Normal	Borrowers can honor the terms of their loans. There is no reason to doubt their ability to repay principal and interest in full on a timely basis.
Special mention	Borrowers are able to service their loans currently, although repayment may be adversely affected by specific factors.
Substandard . . .	Borrowers' abilities to service their loans are in question as they cannot rely entirely on normal business revenues to repay principal and interest. Losses may ensue even when collateral or guarantees are invoked.
Doubtful	Borrowers cannot repay principal and interest in full and significant losses will need to be recognized even when collateral or guarantees are invoked.
Loss	Only a small portion or no principal and interest can be recovered after taking all possible measures and exhausting all legal remedies.

(1) Banks may implement more detailed guidelines consistent with these definitions. See "Assets and Liabilities — Assets — Asset Quality of Our Loan Portfolio — Distribution of Loans by Loan Classification" for a description of the guidelines we have implemented.

Loan Allowances

Under the Guidelines on Loan Loss Provisions, banks in China are required to make provisions based on a reasonable estimate of the probability of loss on a prudent and timely basis. According to the Loan Classification Principles, a loan classified as substandard, doubtful or loss is considered to be non-performing. Allowances for impairment losses consist of general allowances, specific allowances and special allowances. Banks are required to make provisions for impairment losses on a quarterly basis, and to have a general allowance of not less than 1% of the total loans outstanding as of December 31 of any year. The guidance on specific allowances is as follows: for special mention loans, 2%; for substandard loans, 25%; for doubtful loans, 50%; and for loss loans, 100%. Specific allowances for substandard loans and doubtful loans may be maintained at levels ranging within 20% of the guidance level. Commercial banks may make special provisions on a quarterly basis in accordance with special risk factors (including risks in association with certain industries and countries), general loss rates and historical experience. The allowance for impairment losses derived pursuant to the Guidelines on Loan Loss Provisions, however, is not used for our financial reporting

purposes. The allowance for impairment losses disclosed in the prospectus is calculated in accordance with IAS 39.

Allowance and Regulatory General Reserve for Impairment Losses

Pursuant to the Measures on Allowances for Risk-bearing Assets and a subsequent notice issued by the MOF, financial institutions in the PRC are required to maintain adequate allowance for impairment losses against their assets. In addition, financial institutions are also required to set up a regulatory general reserve to cover potential impairment losses that are not yet identified. Financial institutions are required to assess the risk profile of their assets in determining the regulatory general reserve level, which in principle is not less than 1% of the aggregate amount of each financial institution's risk-bearing assets before allowance for impairment losses as at the balance sheet date. Financial institutions are not allowed to make profit distribution to shareholders until adequate allowance for impairment losses and regulatory general reserve have been made. If a financial institution cannot meet the requirement of maintaining the adequate regulatory general reserve as stipulated in the MOF regulations effective on July 1, 2005, it will be required to take necessary steps to ensure that such requirement can be met in approximately three years, but not more than five years, from July 1, 2005. As of December 31, 2006, we did not have any general reserve. With a view to meeting this requirement by July 1, 2010, we plan to appropriate 40% to 45% of our net profit as general reserve in 2007, and 25% to 35% of our net profit as general reserve in 2008 and 2009. See "Financial Information — Dividend Policy."

CBRC Supervision of Loan Classification and Allowances

Commercial banks are required to formulate detailed internal procedures that clearly define the responsibilities of each relevant department with respect to loan classification, approval, review and related matters. In addition, beginning in 2002, commercial banks have been required to submit quarterly and annual reports to the regulators on the classification of their loan portfolios and their allowances for loan losses. Based on its review of these reports, the CBRC may require commercial banks to explain significant changes in loan classification and loan loss allowance levels, or may carry out further inspections.

In 2003, the CBRC published a circular that reiterated the implementation of the PBOC's Loan Classification Principles and provided additional guidance on loan classification criteria. The CBRC supervises and examines commercial banks' implementation of relevant PBOC and CBRC guidelines.

Loan Write-offs

Under the regulations issued by the PBOC and the MOF, PRC banks are required to establish a strict review and approval process to write off loan losses. In order to be written off, a loan needs to meet the standards set by the MOF. Losses realized upon writing off loans are deductible for tax purposes, but such deduction is subject to the review and approval of the tax authorities.

Corporate Governance and Risk Control

Corporate Governance

In accordance with the PRC Company Law, the Commercial Banking Law and other relevant regulations, joint stock commercial banks are required to appoint at least two independent directors (or three independent directors if the registered capital of the bank exceeds RMB 1 billion), and the board of directors of such banks is required to establish a related party transactions committee, risk management committee and audit committee. Banks with registered capital exceeding RMB 1 billion are also required to establish a nomination committee, remuneration committee and strategy committee of the board of directors. They are also required to establish a supervisory board with at least two external supervisors.

Moreover, the Corporate Governance Guidelines for Joint Stock Commercial Banks and the Guidelines for Independent Directors and External Supervisors stipulate that joint stock commercial banks may adopt appropriate measures to improve their corporate governance. For instance, joint stock commercial banks are

required to establish an organizational structure under which management and supervisory powers and responsibilities are separated among the shareholders, the Board of Directors, the Board of Supervisors and the senior management. At least one-quarter but no more than one-third of the board of directors should be comprised of senior management. Our senior management accounts for less than one-quarter of our board of directors. Therefore, we are not in compliance with the corporate governance requirement. We have been advised by our PRC legal counsel, King & Wood, that the CBRC has not imposed fines on us for such non-compliance but may require us to take remedial actions to rectify such non-compliance. The board of directors should establish special committees to regulate auditing matters and related party transactions, risk management, remuneration and nomination. A board of supervisors should also be established to oversee and supervise the board of directors, senior management and other officers, to examine and supervise the bank's financial activities, to audit and monitor the bank's business decisions, risk management and internal controls, and to provide guidance to the bank's internal auditing department.

In addition, the CBRC issued the Diligence Guidelines for Board of Directors of Joint Stock Commercial Banks (Provisional) on September 12, 2005. The guidelines set forth responsibilities for the Board of Directors, rules and procedures for board meetings, requirements for establishing special board committees, and the supervision on the performance of board's responsibilities.

Internal Controls

Under the Internal Control Guidelines for Commercial Banks issued by the PBOC, commercial banks are required to establish internal controls to ensure effective risk management for their business activities. Commercial banks are also required to establish a risk management department which formulates and implements risk management policies and procedures. In addition, banks are required to establish an internal audit department that can independently supervise and evaluate all aspects of the banks' operations. Internal controls should be regularly evaluated and, if necessary, improved. Since February 2005, the CBRC has been conducting periodical evaluations of the internal controls of commercial banks and has been taking regulatory action based on the results of its evaluations.

Since its inception, the CBRC has published a number of risk management guidelines and rules in an effort to improve risk management in China's commercial banks. The CBRC's guidelines and rules contain specific requirements for controlling various types of risk, including market risk, operational risk, and credit risk relating to real estate loans, loans to group borrowers and derivatives transactions. Commercial banks are required to identify, monitor, control and prevent risks and to enhance their internal controls, all in accordance with the CBRC's guidelines.

On June 27, 2006, the CBRC issued the Internal Audit Guidelines for Financial Institutions in the Banking Industry, which became effective on July 1, 2006. Pursuant to the guidelines, banks are required to establish an audit committee of the board of directors with at least three members, a majority of which must be non-executive directors. Banks are also required to have an internal audit department with employees that meet certain qualifications, the number of which should be in principle 1% of the total number of employees of the bank. The guidelines set forth the required scope of the internal audit. It requires banks to perform risk evaluation of each business unit at least once per year, and conduct internal audit of each business unit at least once every two years.

Disclosure Requirements

Under the Tentative Measures on Information Disclosure of Commercial Banks issued in May 2002, commercial banks with total assets of RMB 1.0 billion or more or deposits of RMB 500 million or more are required to publish financial statements audited by qualified accounting firms in their annual reports. In addition, they are required to disclose information relating to the bank's risk management, corporate governance, ten largest shareholders, related party transactions and other significant information relating to the bank during the relevant fiscal year. The financial statements shall include, among others, the capital adequacy ratios, liquidity ratios and loss provisions. The annual reports are required to be published within four months after the end of each fiscal year.

Transactions with Related Parties

In accordance with the Administrative Measures on Connected Transactions between Commercial Banks and Insiders and Shareholders, related parties include, among others, (i) shareholders holding or controlling 5% or more of the bank's outstanding shares or voting rights; (ii) legal persons or other organizations under direct or indirect common control with the bank; (iii) such legal persons' or organizations' individual controlling shareholders, directors and key officers; (iv) directors, senior management, loan officers and their respective close relatives, and organizations in which the above persons have investments or serve as executive officers; and (v) other individuals, legal persons or other organizations that have direct, indirect or joint control over the commercial banks or that may exert significant influence over them. Transactions with related parties include, among other transactions, credit extensions, asset transfers, and the provision of services, and if required, such transactions should be reported to the CBRC and published in their annual reports. Commercial banks are required to adopt appropriate policies and procedures to manage related party transactions and to establish a related party transaction examination committee of the board of directors to supervise the implementation of, and compliance with, such policies and procedures and to examine proposed related party transactions.

Transactions with related parties are subject to certain limitations. For example, when the amount of any single related party transaction represents more than 1% of the bank's regulatory capital, or any single related party transaction will cause the total outstanding value of transactions with that related party to represent more than 5% of the bank's regulatory capital, the transaction must be examined by the related party transaction control committee of the commercial bank and submitted to the board of directors for approval. It must also be reported to the supervisory board of the bank and the CBRC within ten business days after such board approval. In addition, commercial banks may not grant unsecured loans to related parties or extend credit secured by the bank's own equity. They may not provide security for the financing activities of related parties, unless such related parties provide adequate counter-security in the form of deposit certificates or treasury bonds. The credit facilities granted to a single related party may not exceed 10% of the commercial bank's regulatory capital. The credit facilities granted to all affiliates of a related party may not exceed 15% of the bank's regulatory capital. The aggregate amount of credit facilities granted to all related parties may not exceed 50% of the bank's regulatory capital. We were in compliance with these related party credit concentration limits in the periods presented in this prospectus.

Commercial banks must submit to the CBRC, on a quarterly basis, status reports regarding their related party transactions, and disclose matters relating to related parties and related party transactions in their financial statements. Furthermore, the board of directors is required to report annually at the shareholders' meetings related party transactions and the implementation of mechanisms for monitoring and approving related party transactions. The CBRC has the power to request the rectification of transactions that violate the Related Party Transactions Measures and impose sanctions on the bank and/or the related parties.

Compliance Risk Management

On October 25, 2006, the CBRC promulgated the Guidelines on Compliance Risk Management of Commercial Banks to strengthen the compliance risk management of PRC commercial banks. These Guidelines address, among other things, (i) responsibilities of the board of directors, board of supervisors and senior management in compliance risk management; (ii) responsibilities of the compliance department; and (iii) supervision of a bank's compliance risk management by regulatory authorities.

Under the Guidelines, commercial banks are required to establish compliance risk management system compatible with their scope of business, organization structure, and business scale. Such system must cover, among other things:

- compliance policies;
- the organizational structure and resources of the compliance department;
- plans to ensure compliance;

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- risk management;
- a set of procedures for the identification and management of compliance risk; and
- a system for compliance training and education.

We have established the required compliance risk management policies and procedures and are in compliance with the Guidelines.

Operational Risk Management

In March 2005, the CBRC issued the Circular on Strengthening Control of Operational Risk to further strengthen PRC commercial banks' ability to identify operational risk and the risk management and control of such risk. Under this circular, PRC commercial banks are required to establish internal policies and procedures specifically for the management and control of operational risk. A bank's internal audit department and business operation departments are required to conduct independent and ad hoc reviews and examinations of the bank's business operations from time to time. For business areas involving a greater degree of operational risk, ongoing reviews and examinations are required. Moreover, a PRC commercial bank's head office is required to assess, from time to time, the implementation of and compliance with its internal policies and procedures on operational risk.

In addition, the circular sets forth detailed requirements for PRC commercial banks to follow, which include, among other things, establishing a system under which branch officers in charge of business operations are required to rotate on a regular basis; establishing a system to encourage full compliance with applicable regulations and internal rules and policies by all employees; improving the timely reconciliation of the account statements between commercial banks and their customers and those between operational departments and accounting departments within a bank; segregating persons in charge of account-keeping and persons in charge of account reconciliation; and establishing a system for the control and management of specimen signatures and banking transaction documents.

Market Risk Management

In December 2004, the CBRC promulgated the Guidelines on Market Risk Management of Commercial Banks to strengthen the market risk management of PRC commercial banks. These guidelines address, among other things, (1) the responsibilities of the board of directors and senior management of a bank in the supervision of market risk management, (2) policies and procedures for market risk management, (3) the detection, quantification, monitoring and control of market risk, and (4) responsibilities for internal controls and conducting external audits.

Under these guidelines, commercial banks are required to establish formal written policies and procedures to manage market risk. These policies and procedures must cover, among other things:

- permitted business activities, such as the trading of and investment in certain financial instruments;
- the level of market risk acceptable to the bank;
- the organizational structure for market risk management;
- a set of procedures for the detection, quantification, monitoring and control of market risk; and
- an information system for market risk management.

Information System Risk Management

The CBRC issued the Guidelines for Information System Risk Management in Banking Institutions on November 1, 2006, with the view to effectively preventing risks from the operation of information system for business transactions, operation management and internal controls. The guidelines provide for, among other things, (1) scope of responsibilities of relevant agencies, (2) overall risk controls, (3) research and

development risk controls, (4) operational maintenance risk controls, (5) outsourcing risk controls, and (6) information system risk audits.

Pursuant to the guidelines, banking institutions shall diligently apply the following requirements in connection with management of their information system:

- complying with PRC laws, regulations and technical specifications relating to information system management, and implementing regulatory requirements of CBRC;
- putting in place effective information security and internal control systems, designing and ensuring implementation of post-specific functions in connection with information system risk management;
- conducting examination, review and analysis of risks inherent in information systems bank-wide, and promptly reporting the results to their governing committee, as well as CBRC and the local office of CBRC;
- promptly reporting to CBRC and its local office any material incidence or emergency occurred relating to its information systems, and make quick response according to the contingency plans;
- submitting annual reports on information system risk management to CBRC and its local office upon review by the board of directors or other governing body;
- conducting audit of their information systems in a satisfactory manner;
- assisting CBRC and its local office in supervising and examining risks prevention measures for information system, and making rectifications according to regulatory comments; and
- providing trainings for relevant personnel on the operations, technology and security in respect of information system.

The Guidelines became effective as of November 1, 2006 and we are in compliance with the Guidelines.

Risk Rating System

We have been subject to evaluation by the CBRC based on a provisional risk rating system since February 2004. Under this system, capital adequacy, asset quality, management quality, profitability, liquidity and exposure to market risk of joint stock commercial banks are evaluated and scored by the CBRC on a continuous basis. Each bank is classified into one of five risk rating categories. The CBRC determines its supervision activities, including the frequency and scope of its on-site inspections, with respect to that bank based on its risk rating category. The risk rating also constitutes a basis for the CBRC's evaluation of the bank's applications for new business licenses and the qualifications of its senior management. These risk ratings are not publicly available.

Restrictions on Equity Investments in Banks and Shareholders

Any natural or legal person intending to acquire 5% or more of the total equity interest of a commercial bank is required to obtain prior approval from the CBRC. If any existing shareholder of a commercial bank increases its shareholding in excess of the 5% threshold without obtaining the CBRC's prior approval, that shareholder will be subject to CBRC sanctions, which include, among others, rescission of the acquisition and disgorgement of profits, if any. Furthermore, the bank and the relevant shareholder may also be subject to fines imposed by the CBRC for not obtaining the prior approval from the CBRC.

Under the Administrative Measures on Equity Investments of Overseas Financial Institutions in Domestic Financial Institutions, certain foreign financial institutions may make equity investments in PRC commercial banks, subject to the CBRC's approval. However, no single foreign financial institution may own more than 20% of the equity of such banks. Foreign financial institutions which the CBRC deems as related parties are counted as one financial institution when calculating such entities' equity interest in PRC commercial banks. In addition, if foreign investment in the aggregate exceeds 25% of the total equity interest in a non-listed PRC commercial bank, such bank will be regulated as a foreign-invested bank. A listed

domestic commercial bank will continue to be regulated as a domestic bank even if foreign investment in the aggregate exceeds 25% of its total equity interest.

Under the PRC Company Law and relevant rules and regulations, a joint stock commercial bank may not accept its own shares as collateral. Moreover, there are legal limitations on the ability of shareholders of a joint stock commercial bank to pledge to any other party their shares in the bank. According to the Corporate Governance Guidelines, (i) any shareholder of a joint stock commercial bank must give prior notice to the board of directors of the bank if it wishes to pledge its shares as collateral, and (ii) if the outstanding amount of the bank's loans to a shareholder exceeds the audited value of such shareholder's equity in the bank for the immediate preceding year, and such shareholder does not pledge any government bonds or bank deposit certificates as collateral, the shareholder may not pledge its shares. Under our articles of association, which have been approved by the CBRC, this restriction applies only to those shareholders that hold 5% or more of our shares. We have been advised by our PRC legal counsel, King & Wood, that this provision of our articles of association is legal and valid under PRC law.

Anti-Money Laundering Law and Regulation

According to the PRC's Anti-Money Laundering Law, the PRC commercial banks should establish a sound internal anti-money laundering control system, and the principal executives of the commercial bank should be responsible for the effective implementation of the internal anti-money laundering control system. The commercial bank should, according to the requirement, establish a customer identification system, a customer identify data and transaction record preserve system, and a large dealings and suspicious transaction report system. Whenever necessary, according to the applicable legal proceeding, the commercial bank should cooperate with the government authorities in respect of the anti-money laundering and restraining the assets. The competent department of anti-money laundering under the State Council is responsible for the supervision and management of the anti-money laundering. The Anti-Money Laundering Law became effective on January 1, 2007.

Under Anti-Money Laundering Regulation, the PBOC is the primary department of the State Council responsible for supervising and regulating anti-money laundering of financial institutions. Financial institutions must establish a sound anti-money laundering internal control system, set up an independent department or designate a relevant department to anti-money laundering matters, formulate internal operating and control procedures for anti-money laundering, and offer anti-money laundering trainings to the relevant employees to enhance their anti-money laundering capabilities. The principals of financial institutions must be responsible for the effective implementation of the anti-money laundering internal control system. Financial institutions are required to establish and implement a customer identification system in accordance with relevant regulations, properly preserve the customers identity information, as well as the relevant transaction materials, such as the data, business certificates, account books, and report to the Anti-Money Laundering Monitoring and Analyzing Center on a timely basis the transactions involving large amounts of Renminbi and foreign exchange transactions and suspicious transactions. Financial institutions are also required to promptly submit a written report to local branches of the PBOC upon the detection of any suspicious transaction involving criminal offences in the course of performing their anti-money laundering obligations. Such requirements became effective on January 1, 2007.

We have established an anti-money laundering system pursuant to the relevant anti-money laundering laws and regulations, and designated the accounting department to be responsible for its implementation. Our anti-money laundering system includes, among others, the following measures:

- (1) Individual clients should produce his or her identification card (or, if by way of agency, identification card of the agent as well as the principal) before opening savings account or conducting settlement businesses, and the name and number shown on the identification card are required to be examined and recorded.
- (2) Corporate clients should produce valid evidence as required under anti-money laundering regulations before opening accounts, making deposits and conducting settlement businesses, which are required to be examined and recorded;

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- (3) A reporting system has been established to monitor, compile and report transactions involving large amount and suspicious transactions;
- (4) Ongoing anti-money laundering trainings should be conducted to enable our employees to understand relevant anti-money laundering laws and regulations, and improve their abilities to identify suspicious transactions; and
- (5) A system of keeping account information and transaction records has been established pursuant to the relevant anti-money laundering laws and regulations.

During the period from 2004 to 2006, we failed to report certain transactions to the relevant regulatory authorities in a timely manner pursuant to the applicable anti-money laundering regulations. As a result, we were subject to warnings and fines by the PBOC with the aggregate amount of approximately RMB 217,000. We have paid the fines in full amount, and taken necessary steps to correct the violations and continuously strengthen our supervision on anti-money laundering, including enhancing our information technology system. We believe we have established the required policies and procedures to ensure compliance with the anti-money laundering laws and regulations.

Regulations of Foreign-invested Banks Operating in China

The PRC Administrative Regulations on Foreign-invested Banks (the “Regulations”) were adopted by the Standing Committee of the State Council on November 8, 2006 and became effective on December 11, 2006. In accordance with China’s WTO commitments, the Regulations specify the establishment, registration and business scope of wholly foreign-owned banks, Sino-foreign joint venture banks and branches of foreign banks operating in China. The minimum registered capital of wholly foreign-owned banks and Sino-foreign joint venture banks may not be less than RMB 1 billion or equivalent foreign currencies which are freely exchangeable. The sole or controlling foreign shareholder who intends to establish a wholly foreign-owned bank or a Sino-foreign joint venture bank must have year-end total assets no less than US\$10 billion for the year prior to making application for establishment of the wholly foreign-owned bank or the Sino-foreign joint venture bank. In addition, the branches of foreign banks in China are required to have a minimum working capital of RMB 200 million or equivalent foreign currencies which are freely exchangeable, and their ratios of current assets to current liabilities may not be lower than 25%. The foreign bank who intends to establish a branch must have year-end total assets no less than US\$20 billion for the year prior to making application for the establishment of the branch.

In accordance with the new Regulations, wholly foreign-owned banks and Sino-foreign joint venture banks may take deposits from the public, act as insurance agent, engage in inter-bank lending, make loans, and provide credit cards and other products. In addition, the new regulations permit branches of foreign banks in China to take time deposits of no less than RMB 1 million. The Regulations eliminated previous restrictions on foreign-invested banks that only allow them to provide Renminbi-denominated banking services in 25 cities.

HONG KONG FINANCIAL DISCLOSURE REQUIREMENTS

Pursuant to Rule 4.10 of the Hong Kong Listing Rules, the financial information to be disclosed in our Accountants’ Report must be in accordance with best practice, which is at least that required to be disclosed in respect of specific matters in the accounts of a company under the Hong Kong Companies Ordinance, IFRS and guidelines issued by the Hong Kong Monetary Authority, or HKMA, namely “Financial Disclosure by Locally Incorporated Authorised Institutions” and “New Hong Kong Accounting Standards: Impact on Interim Financial Disclosure,” or the Guidelines.

Pursuant to FD1-2.2.2 of the Financial Disclosure by Locally Incorporated Authorised Institutions issued by the Hong Kong Monetary Authority (the “Guidelines”), a separate disclosure is required in relation to movements in the allowance for loan impairment losses for individually assessed and for collectively assessed loans. We were able to provide such information in respect of the year ended December 31, 2006 but not the years ended December 31, 2005 and 2004. We believe such information is immaterial to potential investors.

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Pursuant to FD1-2.2.2 of the Guidelines, a separate disclosure is required in relation to the amount of new provisions charged to the income statement and the amount of provisions released back to the income statement in the movement of allowance for loan impairment losses. We are currently unable to provide such disclosure as such information is currently not available. We believe that such disclosure is immaterial to potential investors under the Global Offering. However, we are endeavouring to collect the relevant information so that we will be in a position to provide such required disclosure under the Guidelines by December 2008.